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Message Text

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PASS CEA, TREAS, FRB

E.O. 11652: N/A
TAGS: OECD, ECON
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC) REVIEW OF SWEDEN

REF: A) EDR(77)8; B) STATE 59749; C) OECD PARIS 7318

1. SUMMARY: AT MARCH 18 EDRC REVIEW OF SWEDEN, SWEDISH DEL (LED BY WOHLIN, ECONOMICS MINISTRY) EMPHASIZED THAT GOS INTENDED TO MAINTAIN ITS EFFORT TO OFFSET EFFECTS OF INTERNATIONAL BUSINESS CYCLE BY SUPPORTING DOMESTIC DEMAND DESPITE HIGH COST IN TERMS OF LARGE CURRENT ACCOUNT DEFICIT. THEY ADDED, HOWEVER, THAT SECRETARIAT'S ASSESSMENT OF SWEDISH COMPETITIVE POSITION WAS OVERLY SANGUINE AND THAT CONTINUATION OF HIGH INFLATION RATE WOULD HAVE SERIOUS EXTERNAL CONSEQUENCES WHICH WOULD NECESSITATE RESTRICTIVE SHIFT OF DEMAND MANAGEMENT POLICIES. RESULTING RISE IN UNEMPLOYMENT RATE WOULD THROW INTO QUESTION THE SUCCESS OF POLICIES OVER LAST TWO YEARS
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SWEDEN AGREED WITH SECRETARIAT VIEW THAT EXTERNAL DEBT HAD NOT REACHED SERIOUS PROPORTIONS, BUT NOTED THAT DEBT SERVICE WOULD BE HEAVY DRAIN ON CURRENT ACCOUNT. SWEDES REJECTED SECRETARIAT RECOMMENDATION THAT EXPANSIONARY FISCAL POLICY PLANNED FOR 1977 SHOULD BE DROPPED IN FAVOR OF INCREASED EMPHASIS ON SELECTIVE STIMULUS, NOTING THAT FULL ARSENAL OF SELECTIVE MEASURES WAS ALREADY IN PLACE

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AND THAT THEY INTENDED TO AVOID RESTRICTIVE FISCAL POLICY (IF POSSIBLE) UNTIL INCREASE IN EXPORT DEMAND WAS SUFFICIENT TO MORE THAN COUNTERBALANCE TIGHTENING ON FISCAL SIDE. EDRC FOCUSED ON SECRETARIAT AND GOS EXPECTATIONS THAT GDP GROWTH WOULD BE MODERATE IN 1977 WHILE CURRENT ACCOUNT AND INFLATION PERFORMANCE WOULD IMPROVE ONLY SLIGHTLY, IF AT ALL, AND CONCLUDED THAT GOS WILL HAVE DIFFICULTY RECONCILING THE GOALS OF FULL EMPLOYMENT AND CURRENT ACCOUNT BALANCE. END SUMMARY

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK FOR 1977: LIKE SECRETARIAT, SWEDES EXPECT ONLY MODERATE (1.5-1.6 PERCENT) RISE IN REAL GDP IN 1977. MAIN SUPPORT WILL COME FROM GROWTH OF PUBLIC AND PRIVATE CONSUMPTION, WHILE OTHER COMPONENTS OF DOMESTIC DEMAND AND PROJECTED MOVEMENT IN REAL FOREIGN BALANCE WILL HAVE NEGATIVE INFLUENCE ON GDP GROWTH. SWEDES NOTED THAT PREVIOUSLY FORECAST 2 PERCENT DECLINE IN REAL MANUFACTURING INVESTMENT SPENDING WOULD BE REVISED DOWNWARD TO SHOW A FALL AS LARGE AS 5 PERCENT. WHILE LIQUIDITY POSITION OF FIRMS HAS WORSENED (GOS ESTIMATES THAT SHARE OF PROFITS IN VALUE ADDED FELL FROM 38 PERCENT TO 30 PERCENT BETWEEN 1974 AND 1976), MAIN REASON FOR POOR INVESTMENT OUTLOOK IN SHORT RUN IS, ACCORDING TO SWEDES, SUBSTANTIAL DEGREE OF EXCESS CAPACITY. U.S. NOTED THAT GOS ANALYSIS IMPLIED CONTRARY TO SECRETARIAT EVALUATION, THAT OPERATION OF INVESTMENT RESERVE FUND HAS PROVIDED ONLY MINIMAL STIMULUS TO INVESTMENT; SWEDES AGREED. SWEDES HAVE SET OBJECTIVE OF LIMITING REAL INCREASE IN PRIVATE CONSUMP-
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TION SPENDING THIS YEAR TO 2.5 PERCENT AND PLAN TO INCREASE INDIRECT TAXES BY AN AMOUNT WHICH WOULD ACHIEVE THIS RESULT.

3. GOS PROJECTS 8 BILLION KRONER NEGATIVE SWING IN INVENTORIES IN 1977 WHICH IMPLIES 2 PERCENT NEGATIVE CONTRIBUTION OF STOCK MOVEMENTS TO 1977 GDP GROWTH. DESPITE FACT THAT STOCK SUPPORT SCHEME IS SCHEDULED TO EXPIRE ON JUNE 30, 1977, SWEDES FELT THAT DEPRESSIVE EFFECT ON STOCK MOVEMENTS IN GDP WOULD NOT INTENSIFY IN LATE 1977 OR IN 1978. U.S. CITED SECRETARIAT ANALYSIS INDICATING THAT NEGATIVE CONTRIBUTION OF STOCK MOVEMENTS TO GDP GROWTH WOULD HAVE TO BE ABOUT 4 PERCENT IN 1977 IN ORDER FOR "NORMAL" INVENTORY/SALES RATIO TO BE ESTABLISHED BY YEAR-END. U.S. CONCLUDED THAT GOS STOCK FORECAST CONTAINED IMPORTANT DOWNSIDE RISK. SWEDES REPLIED THAT

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PROJECTED HIGHER LEVELS OF PRODUCTION WOULD ENTAIL CONCOMITANT INCREASE IN INVENTORY REQUIREMENTS AND THAT SECRETARIAT ESTIMATES OF WHAT WOULD CONSTITUTE A "NORMAL" INVENTORY/SALES RATIO WERE TOO PESSIMISTIC.

4. WAGES AND PRICES: NOTING THAT WAGE NEGOTIATIONS WERE STILL GOING ON, SWEDES STRESSED THAT COURSE OF WAGES IN 1977 CONSTITUTES MAJOR ELEMENT OF UNCERTAINTY IN PRICE OUTLOOK. THEY SAID, HOWEVER, THAT TOTAL WAGE COSTS (INCLUDING SOCIAL CHARGES) WOULD PROBABLY RISE BY MORE THAN 8 PERCENT IN 1977 AND THAT THIS WOULD IMPLY AN AVERAGE ANNUAL CONSUMER PRICE INCREASE OF MORE THAN 7 PERCENT. SECRETARIAT STRONGLY SUGGESTED THAT GOS CONSIDER OFFERING TAX CONCESSIONS WITHIN FRAMEWORK OF AN INCOMES POLICY TO SECURE MODERATION IN NOMINAL WAGE INCREASES. SWEDES UNDERLINED ORGANIZED LABOR'S OPPOSITION TO INCOMES POLICIES, BUT STATED THAT THEY WOULD NOT OBJECT TO INCLUSION IN REVISED DRAFT SURVEY OF GENERAL RECOMMENDATION IN FAVOR OF AN INCOMES POLICY. SEVERAL

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DELS HOMED IN ON INFLATIONARY IMPACT OF INCREASINGLY ONEROUS SOCIAL CHARGES ON FIRMS. SWEDES INDICATED THAT ALTHOUGH SOCIAL CHARGES CURRENTLY REPRESENTED 35 PERCENT OF TOTAL WAGE COSTS, AND COULD RISE TO 41 PERCENT THIS YEAR, SWEDISH EXPERIENCE WAS THAT SUCH COSTS HAD BEEN "SHIFTED BACKWARD" OVER MEDIUM-TERM AND HAD THUS BEEN ABSORBED BY WAGE EARNERS (THROUGH SMALLER WAGE INCREASES) INSTEAD OF BEING PASSED ON IN PRICES. THEY ADDED, HOWEVER, THAT SHORT-RUN EFFECTS OF MOUNTING SOCIAL CHARGES COULD BE INFLATIONARY.

5. CURRENT ACCOUNT: SWEDES TOOK ISSUE WITH SECRETARIAT VIEW THAT DRAMATIC LOSS OF MARKET SHARES BETWEEN 1974 AND 1976 WAS IMPORTANTLY DUE TO CYCLICAL OR SPECIAL CONDITIONS AND HENCE DID NOT REFLECT SERIOUS DETERIORATION OF SWEDISH COMPETITIVE POSITION. THEY ARGUED THAT (A) MOVEMENTS IN CURRENT ACCOUNT BALANCE WERE INVERSELY RELATED TO CHANGES IN RELATIVE UNIT LABOR COSTS; TREND TOWARD CURRENT ACCOUNT IMPROVEMENT FROM 1965-74 COINCIDED WITH PROGRESSIVE FALL IN RELATIVE UNIT LABOR COSTS WHILE OPPOSITE HAS OCCURRED SINCE 1974; (B) SECRETARIAT ASSUMPTION THAT SHARP RISE IN UNIT LABOR COSTS IN RECENT YEARS DUE TO POLICY INDUCED "LABOR-HOARDING" WOULD NOT SIGNIFICANTLY AFFECT PRICES (BECAUSE FIRMS BASE THEIR PRICES ON TREND RISE IN PRODUCTIVITY; I.E., NORMAL COSTS) WAS UNWARRANTED. FIRMS' PRICING BEHAVIOR REFLECTS ACTUAL, RATHER THAN "NORMAL," COSTS; (C) FULL BENEFIT OF SO-CALLED PRODUCTIVITY RESERVE (TREND PRODUCTIVITY MINUS ACTUAL PRODUCTIVITY) ACCUMULATED SINCE 1974 MAY NOT MATERIALIZE IN UPSWING. MOREOVER, GOS LABOR RETENTION INDUCEMENTS MAY HAVE REDUCED MOBILITY OF LABOR FORCE AND SLOWED DOWN NECESSARY STRUCTURAL CHANGES WITH ADVERSE EFFECTS ON FUTURE PRODUCTIVITY GROWTH AND, (D) DOMESTIC FIRMS WILL SUFFER AT EXPENSE OF IMPORTS IN 1977. SECRETARIAT FORECAST OF 3.5 PERCENT RISE IN IMPORT VOLUMES TOO OPTIMISTIC; MORE LIKELY OUTCOME WOULD
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BE INCREASE OF ABOUT 7 PERCENT; (E) DECLINE IN PRODUCTIVITY OF CAPITAL INDICATED BY RISING CAPITAL/OUTPUT RATIO.

6. NORWEGIANS CHIMED IN ON SWEDISH SIDE BY CITING BANK OF NORWAY CALCULATIONS WHICH SHOWED 66 PERCENT INCREASE IN SWEDISH RELATIVE UNIT LABOR COSTS BETWEEN 1973 AND 1976. SECRETARIAT AND SWEDISH DEL AGREED TO DISAGREE ON THIS POINT, SINCE DIFFERENCES BETWEEN THEM RESULTED IMPORTANTLY FROM DIVERGENT THEORETICAL VIEWS ON FIRMS' PRICING BEHAVIOR OR FROM TECHNICAL VARIANCES (E.G., GOS USES LASPEYRE PRICE INDEX, SECRETARIAT PAASCHE INDEX). IN REVISED DRAFT SURVEY, SECRETARIAT WILL TAKE GOS VIEWS

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INTO ACCOUNT BY INDICATING THAT ON BASIS OF ITS OWN CAL-
CULATIONS, THERE WOULD BE SOME CAUSE FOR CONCERN AT EVO-
LUTION OF SWEDISH COMPETITIVE POSITION AND BY POINTING
OUT THAT THIS CONCERN WOULD BE INTENSIFIED IF GOS FIGURES
WERE USED. SWEDISH DEL AND EDRC ACCEPTED THIS FORMULA-
TION AND AGREED WITH FUNDAMENTAL SECRETARIAT AND SWEDISH
POINT THAT IMPROVEMENT IN SWEDISH COMPETITIVE POSITION
OVER MEDIUM-TERM IS ESSENTIAL.

7. SWEDES ALSO OBJECTED TO SECRETARIAT'S RELATIVELY
OPTIMISTIC EVALUATION OF IMPLICATIONS OF RECENT AND
EXPECTED ACCUMULATION OF EXTERNAL DEBT. THEY STATED
THAT ALTHOUGH SWEDEN HAD ONLY RECENTLY BECOME A NET
DEBTOR, INTEREST CHARGES ON DEBT WOULD HAVE IMPORTANT

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NEGATIVE INFLUENCE ON CURRENT BALANCE IN FUTURE. (THEY
DID NOT HAVE SPECIFIC MEDIUM-TERM FORECASTS OF CURRENT
ACCOUNT, DEBT OR DEBT SERVING COSTS.)

8. ALTHOUGH GOS FORECASTS ONLY 6 PERCENT GROWTH OF
EXPORTS IN 1977 (DESPITE OVERHANG OF INVENTORIES OF
EXPORTABLES AND FORECAST 9 PERCENT GROWTH OF MARKETS)
AND CONTINUATION OF LARGE CURRENT ACCOUNT DEFICIT ($3

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BILLION), SWEDES REJECTED USE OF EXCHANGE RATE DEVALU-
ATION TO BRING ABOUT CURRENT ACCOUNT BALANCE. THEY
EXPLAINED THAT PRIME GOS POLICY OBJECTIVE WAS TO UNWIND
INFLATIONARY EXPECTATIONS AND THAT DEVALUATION OF KRONER
WOULD IMPEDE ATTAINMENT OF THAT OBJECTIVE. MOREOVER,
THEY ARGUED THAT FOR DEVALUATION TO HAVE FAVORABLE EFFECT
ON EXPORT AND IMPORT VOLUMES, IT WOULD HAVE TO BE BACKED
UP WITH RESTRICTIVE DEMAND MANAGEMENT POLICIES -- A MOVE
WHICH GOS HOPED TO AVOID. (THEY DID NOT PURSUE THE
DILEMMA INHERENT IN THEIR STATEMENT, NAMELY, THAT CONTINU-
ATION OF EXPANSIONARY FISCAL POLICY WOULD ACCENTUATE
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PRESSURES FOR DEVALUATION.) SWEDEN ALSO BELITTLED
EFFICACY OF DIFFERENTIAL DEMAND MANAGEMENT POLICIES IN
SURPLUS AND DEFICIT COUNTRIES IN ACCELERATING ADJUSTMENT
PROCESS. THEY STATED VIEW THAT MALDISTRIBUTION OF INTRA-
OECD CURRENT ACCOUNT DEFICIT HAD STRUCTURAL CAUSES AND
THAT ACCELERATION OF ADJUSTMENT PROCESS DEPENDED ON
STRUCTURAL SHIFTS IN DEFICIT AND SURPLUS COUNTRIES (AS
OUTLINED PARA 11, REF C). SWEDES ACKNOWLEDGED THAT BY
SELECTING PRIVATE AND PUBLIC CONSUMPTION AS ENGINES OF
GROWTH IN 1977, GOS WAS ACTING CONTRARY TO THIS DICTUM,
BUT STATED THAT FOR GOS MAINTENANCE OF LOW UNEMPLOYMENT
HAD HIGHER SHORT RUN PRIORITY THAN DID CURRENT ACCOUNT
ADJUSTMENT.

9. FISCAL AND MONETARY POLICY: SWEDES EMPHASIZED THAT
THEIR POLICIES DURING RECESSION AIMED AT HOLDING
UNEMPLOYMENT RATE DOWN AND THEREBY MAINTAINING GROWTH OF
PRIVATE CONSUMPTION. ONLY IN THIS WAY, THEY FELT, COULD
THEY MAINTAIN GROWTH OF PRIVATE MANUFACTURING INVESTMENT
WHICH WOULD GUARANTEE THAT RECOVERY WOULD NOT BE ABORTED
BY SHORTAGE OF INDUSTRIAL CAPACITY (AS WAS THE CASE IN
RECOVERY IN 1969). MOREOVER, THEY DIFFERED WITH SECRE-
TARIAT VIEW THAT EXPANSIONARY FISCAL POLICY PLANNED BY
GOS FOR 1977 SHOULD BE DROPPED IN FAVOR OF INCREASED
EMPHASIS ON SELECTIVE STIMULUS TO PUBLIC INVESTMENT OR
TO CERTAIN SECTORS HARD HIT BY RECESSION, BUT WHOSE
LONGER-TERM PROSPECTS WERE GOOD. SWEDES REMINDED SECRE-
TARIAT THAT GOS HAD HAD RECENTLY IMPLEMENTED A NEW SET
OF SELECTIVE MEASURES, INCLUDING ADDITIONAL TRAINING
SUBSIDIES, MEASURES TO FACILITATE BORROWING BY FIRMS
WITH HIGH DEBT/EQUITY RATIOS, AND SUBSIDIES FOR ENERGY
SAVING INVESTMENTS AND ENVIRONMENTAL PROTECTION. THEY
ADDED THAT IN DECIDING UPON SELECTIVE MEASURES, IT WAS
DIFFICULT TO DETERMINE WHICH SECTORS HAD FAVORABLE
LONGER-TERM PROSPECTS AND NOTED THAT THEY HAD PREVIOUSLY
CHOSEN TO SUPPORT SHIPBUILDING SECTOR. (THEY CITED
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FRENCH AND UK GOVERNMENTS' INVESTMENT IN CONCORDE AS
ANOTHER CASE IN POINT.)

10. IN ADDRESSING SECRETARIAT'S RECOMMENDATION FOR MORE RESTRICTIVE FISCAL POLICY, SWEDES STATED THAT GOS DID NOT INTEND TO MOVE IN THIS DIRECTION UNTIL GROWTH OF WORLD TRADE AND HENCE OF SWEDISH EXPORTS WAS STRONG ENOUGH TO OFFSET RESULTANT FALL IN TOTAL DEMAND. THUS, THEY SAID THAT THEIR DIFFERENCES ON THIS ISSUE LARGELY CONCERNED TIMING OF RESTRICTIONARY SHIFT AND, IN SHORT RUN, THEY WERE THUS WILLING TO INCUR COST OF CURRENT ACCOUNT DEFICIT TO HELP WARD OFF RISE IN UNEMPLOYMENT RATE. MOREOVER, IN SWEDISH VIEW, NARROWING OF CURRENT ACCOUNT DEFICIT WOULD BE MORE THAN OFFSET BY PROBABLE DECLINE IN PRICES OF EXPORTS OF WHICH THERE ARE LARGE STOCKS. SECRETARIAT WAS UNMOVED BY SWEDISH ARGUMENTS, BUT ADDED THAT IT WOULD BE WILLING TO RECONSIDER ITS RECOMMENDATION FOR LESS EXPANSIONARY FISCAL POLICY WERE GOS TO ERECT AN INCOMES POLICY. U.S. AND AUSTRALIAN DELS STATED OBJECTION TO INCLUSION IN REFDOC OF LANGUAGE WHICH WOULD IMPLY THAT INCOMES POLICIES AND DEMAND MANAGEMENT POLICIES WERE SUBSTITUTABLE.

11. MONETARY POLICY: SWEDES SAID THAT MONETARY POLICY DURING 1976 WAS GEARED TO SUPPORT OF KRONER EXCHANGE RATE.

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THEY FELT THAT SECRETARIAT HAD MADE TOO MUCH OF THE RAPID EXPANSION OF BANK CREDIT IN 1976, BUT ACKNOWLEDGED THAT THIS DEVELOPMENT HAD RENDERED KRONER MORE VULNERABLE ON FOREIGN EXCHANGE MARKETS AND HAD LED GOS TO MOVE DECISIVELY TOWARD MONETARY RESTRICTION IN THE THIRD QUARTER OF THE YEAR. ALTHOUGH MANDATORY CEILINGS ON BANK LENDING WILL EXPIRE AT END OF MARCH, 1977, SWEDES INDICATED THAT "VOLUNTARY" LIMITS WOULD CONTINUE TO APPLY AND THAT THESE LIMITS WOULD BE ENFORCED BY VARIATIONS IN BANKS' LIQUIDITY RATIOS (I.E., RESERVE REQUIREMENTS). THUS, THEY DID NOT EXPECT TO ENCOUNTER DIFFICULTY IN CONTROLLING MONEY SUPPLY THIS YEAR.

12. MAIN EDRC CONCLUSION WAS THAT RECONCILIATION BY GOS OF DUAL OBJECTIVES OF CURRENT ACCOUNT BALANCE AND FULL EMPLOYMENT WOULD BE DIFFICULT TO PULL OFF. EDRC WISHED SWEDES LUCK.

13. QUESTIONS RAISED PARAS 2-6, REF B COVERED PARAS 5,
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6, 8 AND 10. RE PARA 5, REF D, SWEDES DID NOT HAVE DETAILS ON NUMBER OF FOREIGN WORKERS IN SWEDEN OVER LAST SEVERAL YEARS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: COMMITTEE MEETINGS, ECONOMIC PROGRAMS, FINANCIAL TRENDS, STUDIES
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Copy: SINGLE
Sent Date: 24-Mar-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977OECDP08650
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770101-0393
Format: TEL
From: OECD PARIS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770326/aaaaawnm.tel
Line Count: 423
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 2698f0b2-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 8
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
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Reference: 77 STATE 59749, 77 OECD PARIS 7318
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 01-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3009047
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC) REVIEW OF SWEDEN
TAGS: ECON, SW, OECD
To: STATE
Type: TE
vdkvgwkey: odbc://SAS/SAS.dbo.SAS_Docs/2698f0b2-c288-dd11-92da-001cc4696bcc
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